

The taxability of maintenance agreements depends upon whether charges for the agreements are included in the selling price of the tangible personal property. See 86 Ill. Adm. Code 140.301. (This is a GIL.)

April 23, 2008

Dear Xxxxx:

This letter is in response to your letter dated November 9, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We are a service company and sell service contracts that may include parts and supplies to the end user. How are these items to be treated for sales and use tax purposes? If the contract is sold to a tax exempt entity (i.e. IDES) are there taxes owed. Our contracts include a provision that the end user is to pay any taxes incurred so is there a preferred way to pass the tax along to the customer. We currently pay the state a use tax, however we could calculate the average cost of the inventory sold in the contracts and bill that portion of the maintenance charge as taxable and the labor and profit portion as non-taxable.

Please advise which is the proper way to handle this tax.

DEPARTMENT'S RESPONSE:

The taxability of maintenance agreements or extended warranties depends upon if charges for the agreements are included in the selling price of the tangible personal property. See Ill. Adm. Code 140.301(b)(3). If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance contracts are sold separately from tangible personal property, sales of the contracts are not taxable transactions. However, when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3). Purchasers of separate maintenance agreements are not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance contract.

Service Occupation Tax would generally apply in a repair situation not covered by a maintenance contract. See 86 Ill. Adm. Code 140.101 through 140.109. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service. Servicemen incur either Service Occupation Tax (SOT) liability or Use Tax liability in these transactions. The tax consequences depend upon the method used to calculate the liability. Servicemen may calculate their tax base in one of four ways: 1. Separately stated selling price; 2. 50% of serviceman's entire bill; 3. SOT on his cost price if he is a registered de minimis serviceman; or, 4. Use Tax on his cost price if he is an unregistered de minimis serviceman that is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Please see 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. A serviceman who incurs Service Occupation Tax on his selling price should provide Certificates of Resale to his suppliers when purchasing tangible personal property that will be transferred to service customers. Please refer to 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

De minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act may use the final method of determining tax liability. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108. These de minimis servicemen do not provide Certificates of Resale to suppliers.

Organizations that qualify as exclusively religious, charitable, or educational can apply to the Illinois Department of Revenue to obtain tax exemption identification numbers ("E" numbers). These numbers establish that the Department recognizes said organizations as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of its organizational purposes. The organization can also use its E number to document its exemption when it receives tangible personal property incident to the purchase of a service transaction. See 86 Ill. Adm. Code 140.125(h) and 160.110(e). Unregistered de minimis servicemen may use their service customer's exempt status to purchase tangible personal property that is to be transferred to an exempt service customer. See 140.108(a)(2)(A).

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Debra M. Boggess
Associate Counsel

DMB:msk